

Executive Summary

The goal of US reconstruction assistance to Iraq is to help develop a democratic, stable, and prosperous Iraq, at peace with itself and its neighbors, enjoying the benefits of a free society and a market economy. In support of this objective, Congress generously appropriated \$2.5 billion in April 2003 and \$18.4 billion in November of 2004 for the Iraq Relief and Reconstruction Fund (IRRF). This report documents that these funds are being spent to create a foundation in the near term upon which the Iraqi government and private sector can build a more secure and prosperous country in the future using Iraq's own revenues, assistance from other bilateral and multilateral institutions, and additional assistance from the USG.

Over the last two years, portions of the IRRF have been used to support the training and equipping of Iraqi security forces, but the majority of the funds have gone to the refurbishing and construction of thousands of health clinics, hospitals and schools; the reconstruction and modernization of the energy, transportation, communications and other sectors fundamental to the transformation of the economy; and many institution-building and technical assistance programs.

IRRF spending has adapted to Iraq's evolving needs, and in response to changing external requirements and constraints. Initially the emphasis was primarily on rebuilding discrete elements of Iraq's pre-war infrastructure, with the immediate goal of restoring essential services such as electricity, water, health, oil production, education, roads and telecommunications. Beginning in the autumn of 2004, greater emphasis was placed on the urgent political priorities such as technical support for the January 2005 elections, the formation of the transitional government, the upcoming constitutional referendum and subsequent national elections, and the readying of the security forces to join the counter-insurgency campaign.

This process of adjusting our support to meet the evolving needs of the Government of Iraq and the Iraqi people continues. This report will identify further ways in which we are refining our programs to best support democratic and economic development and security and stability in the country.

IRRF funds are not the only US government resources being devoted to assist Iraq in reconstruction and institution building. The FY 2005 DoD supplemental provides an additional \$5.3 billion for training and equipping Iraqi security forces and defense funds are also providing commanders in the field with an additional \$320 million in Commanders' Emergency Relief Program (CERP) funds that can finance projects at the local level that address urgent needs.

The IRRF cannot meet all of Iraq's reconstruction and development needs. It serves as one element of a comprehensive strategy for economic development and governmental reform designed to begin addressing issues remaining from the past. Other nations and international organizations are also helping to promote economic growth and political

stability in Iraq. But in the end, only the government of Iraq can initiate comprehensive policy reforms and a development program.

Working with a New Government

With the establishment of the Iraqi Interim Government in June 2004, Iraqi Ministries became full partners in reconstruction and development planning. The planning culminated with the successful conduct of elections in January, which led to the establishment of the Transitional National Assembly (TNA), the first legislative body to directly result from free and fair public elections. Subsequent careful, deliberate and time-consuming consideration by the TNA during this quarter led to the formation of the Iraqi Transitional Government (ITG) in May.

The time spent in forming the ITG delayed decisions, large and small, regarding the implementation of IRRF projects by the ITG ministries on various projects. The transition also made it difficult for some ministries to access their capital budgets through the Iraqi Ministry of Finance. These delays, however, were a necessary price to pay for considerable progress in the development of Iraq's capacity to govern itself. In the process, Iraqis gained greater confidence in the continuity of essential governmental functions despite change in the political leadership.

Since being sworn in, the ITG has taken greater ownership and responsibility for all aspects of the reconstruction agenda, including overall policy and security. Several ministries have appointed resident engineers to provide on-site supervision of reconstruction projects. They have helped draft contracts and made available their approved contractor lists. IRRF projects have been sub-contracted to more Iraq contractors. Contracts have been modified to allow work to be done by Ministry employees and contractors with IRRF-acquired supplies, which has helped foster a better understanding among Iraqis of the construction process and the need for subsequent maintenance. For example, USAID electrical distribution projects in Baghdad were all implemented by Ministry employees with US- provided parts and equipment.

The ITG articulated Iraq's strategic vision for national development in Brussels in June, and continues to refine its National Development Strategy. We anticipate working with the ITG and its Ministries to continue to adapt our efforts to the emerging Iraqi vision and aid in the realization of their strategic goals through our efforts in coordination with other nations and organizations.

Looking Beyond Baghdad through Provincial Outreach

After the January elections, civil-military reconstruction meetings in a number of post-battle cities increasingly drew their leadership from the local citizenry, including businessmen, tribal sheikhs and religious leaders. Groups such as the Fallujah Working Group quickly evolved from vehicles for discussion to vehicles for action.

During the third quarter, we used the lessons learned in Fallujah, along with Basrah and other provinces, to validate our expanded provincial outreach program, where our

Provincial Support Teams (PSTs) working hand-in-hand with Iraqi Provincial Reconstruction Development Committees (PRDCs). The PRDCs will enable provincial Iraqi leaders to have a greater voice in how USG and other funds are used in their provinces, and improve coordination between the governorates and the national government.

Accordingly, the Embassy has encouraged formation of PRDCs in each province, composed of Provincial Council members, representatives of the Governor, and the local Director's General of the national ministries. PRDCs have been established and held initial meetings in all fifteen provinces that are not part of the Kurdish Regional Government group of provinces. Initial steps included comprehensive discussions with provincial government officials, the ITG, Iraqi political leaders and other donors.

The PRDC-PST partnership will help elected Iraqi provincial leaders build governance capacity building, strengthen their elected provincial councils, and improve coordination between national level Ministries and the provinces. Interaction between the governorates and the national government is particularly important to assure provincial officials that support for their local reconstruction efforts will be sustained. It will also help improve the sustainability of Coalition efforts in Iraq.

PSTs are headed by Foreign Service Officers from Regional Embassy Offices or State Embedded Teams with the major subordinate commands (MSCs). Additional representation and collaboration comes from the MSCs and regional IRMO, Project and Contracting Office (PCO) and US Agency for International Development (USAID) representatives. The integrated US team, and its information and resource sharing with the PRDCs are intended to stimulate the development of decision-making by local elected officials.

As initial support to the PRDC, the Embassy requested that IRRF implementing partners bring their own allocated funds to the PRDC to integrate their spending plans, as appropriate, with established Iraqi regional plans and priorities for reconstruction and development. By implementing reconstruction efforts based on the priorities of elected representatives through the PRDC, we are strengthening the very foundations of cooperation between the provincial and national governments that will help Iraq move forward. During the quarter, the USG made available for coordination with the PDRCs, a combined total \$241 million, including \$80 million in military Commander's Emergency Response Programs (CERP) funds, and \$161 million in USAID-administered Community Action Program (CAP) and USAID Local Governance Program (LGP) funds programs.

International Support and Donor Assistance

Recognizing that IRRF funding will not fully restore Iraq's infrastructure and that the ITG is faced with a significant projected budget shortfall for CY 2005 that goes beyond the deficit limit Iraq agreed to with the IMF, the Embassy is working with the United Nations and the World Bank to assist the Iraqi Government in attracting near-term funds from other official donors. Moreover, understanding that the private sector is an

indispensable engine for long-term sustainable economic growth and employment, the USG is working with Iraqis to develop an environment conducive to domestic and international private investment. These efforts are essential to Iraq's long-term economic well-being, but will take considerable time to produce material benefits countrywide.

On June 22, more than 80 countries and international organizations gathered in Brussels to build a new international partnership in support of Iraq. The assembled foreign ministers and other senior officials heard Prime Minister Ja'afari and other ITG ministers describe their vision for how the international community could support Iraq in the three tracks identified in UN Security Council Resolution 1546: the political process, economic reconstruction and security. Although not a pledging conference, many countries expressed willingness to assist Iraq in drafting its constitution, some countries made new commitments of tangible assistance, and the Conference Statement called for non-Paris club debt holders to offer generous terms on debt relief, an idea that was echoed by major creditors who promised to engage in negotiations with the ITG.

On July 10 and 11, the US and Iraq will hold a ministerial meeting in Amman to coordinate reconstruction and economic policy. This meeting of the Joint Commission on Reconstruction and Economic Development, co-chaired by Deputy Secretary of State Robert Zoellick and Finance Minister Ali Allawi, will focus on the economic reforms that the Iraqi Transitional Government is planning to undertake, and on other measures to strengthen the role of the private sector in Iraq's reconstruction. The US and Iraq plan to sign three agreements at this meeting: a Bilateral Assistance Agreement, which establishes the legal framework for a US development assistance partnership with Iraq; a Trade and Investment Framework Agreement, which establishes a council to expand US trade with and investment in Iraq; and an Investment Incentive Agreement, which allows the Overseas Private Investment Corporation to offer its risk insurance and lending guarantee programs in Iraq.

On July 18 and 19, the Donors' Committee of the International Reconstruction Fund Facility for Iraq, which oversees the World Bank and the UN-managed multilateral trust funds, will hold its fourth meeting in Amman. Donors have deposited over \$1 billion of Madrid pledges in these trust funds. The committee is comprised of donors who have contributed at least \$10 million to the trust funds. As has become the tradition, a wider donor meeting will be held the day before the Donors' Committee meeting, which will include all bilateral donors and prospective donors. This will provide a forum for the Iraqis, led by Minister of Planning and Development Cooperation Barham Salih, to discuss in detail their reconstruction priorities, and their plans for improving the ITG's coordination with international donors. The donors will also consider how to improve coordination, and how to accelerate disbursement of their pledges, which include \$13.5 billion from more than 60 countries and international organizations.

Security

We have responded to the continued insurgency by increasing funding to support newly trained Iraqi security forces, personnel, bases and equipment. Planned IRRF direct spending for security is now \$5.0 billion. With another \$5.3 billion in supplemental FY

2005 US spending, contributions from our coalition partners, and substantial funds from the Iraqi annual budget, the programs supported by these funds are producing increasingly capable police and military forces, which will eventually be largely self-sustaining.

There are also direct and indirect security costs embedded in our construction spending, which vary according to project type, location and who is doing the work. It is extremely difficult to track security costs precisely, but IRMO's analysis of program costs indicate that overall security costs account for 16% to 22% of total project costs in Iraq. We are working to refine these estimates. Implementing agencies are working to reduce security costs by reducing risk or ameliorating the security environment of the program. Our efforts at sub-contracting more work to Iraqi firms have had the tangential benefit of lowering the profile of international companies and thereby reducing the security required. However, there is a limit to how much security costs can be reduced without compromising the safety or the effectiveness of the program.

The insurgency has persistently targeted the infrastructure supporting electricity and the oil pipelines that fund the national budget. During the quarter we reacted to continued attacks on oil and electrical infrastructure by increasing planned spending on linear infrastructure security enhancements within our existing security allocations. This effort is to be integrated with and matched by an Iraqi effort to equip and deploy a stronger infrastructure security force over the next 12-18 months.

Building the Capacity to Sustain

Proper management, and operation and maintenance (O&M) practices are essential for Iraq to protect the investment the US and other donors have made in rebuilding Iraq's electricity, water, and other infrastructure. Iraqi management and O&M practices deteriorated significantly during the previous regime, and changing Iraqi practices will take time and effort.

The Embassy intends to help protect the long-term value of the reconstruction projects through a combination of consultative work by IRMO and IRRF-funded training and maintenance contracts. During the quarter, the implementing agencies jointly reviewed the turnover procedures of our contracts and, at the programmatic level, found them to be a good basis for turnover. We are now focused on planning the hand-over of projects, and follow-on sustainment in the near to mid-term future as IRRF projects and programs are completed.

IRRF-funded assistance will only cover a fraction of Iraq's O&M needs; Iraq will have to incorporate more O&M funds within the operating budgets of its ministries. The process of capacity development to manage and sustain infrastructure projects will take time. In the interim, there is a real but unquantifiable O&M risk to IRRF capital investments. While most IRRF construction contracts include some documentation, spare parts and training to maintain the facilities themselves, our experience to date shows that we will

need to remain actively engaged with Iraqi ministries in analysis and collaborative planning, in order to forestall potential shortfalls in O&M capacity.

IRRF SPENDING REVIEW

As of June 29, \$13.6 billion (74 percent of the \$18.4 billion provided in the IRRF) has been obligated. This 13.2 percent increase over last quarter's figure was limited by the impact of the delay in naming a government on our coordination of capital spending. Of this amount, \$6.35 billion has been disbursed. Since submission of the April 5, 2005 report, \$1.6 billion has been obligated and \$2.14 billion disbursed (a more than 50 percent increase). See the Spending Plan attached.

IRRF Spending Changes

These program adjustments to the implementation of the IRRF began with the Summer 2004 Strategic Review; continued with the December 2004 emergency electricity and post-battle reconstruction initiatives that support Iraq's January 2005 elections; and continued with the March reallocation for job creation activities and management program for the electricity and water sectors.

During this quarter we are reallocating \$255.7 million in IRRF funds, of which \$72 million requires Congressional notification, which this report constitutes.

- \$43.5 million to prepare the security forces of Iraq to secure their critical infrastructure and other security and justice related programs (including \$17.5 million linear infrastructure security, \$15 million Central Criminal Court of Iraq, and \$11 million Joint Iraqi American Anti-Terrorism (JTF)).
- \$16 million to improve the flow of oil.
- \$150.2 million to assist the fledgling provincial governments through the Iraqi-led PRDC.
- \$46 million to fund a number of smaller programs designed to aid development of a more open society through the ballot box (including \$40 million to IRI/NDI to support elections, develop campaign skills and increase group participation, and \$6 million for weekly opinion polls).

As reflected in the Status of Funds spread sheet, the Administration notifies Congress in this report that it intends to distribute \$72 million of the aforementioned increases as follows: Project Code 10000 \$6.9 million, Project Code 11000 \$4.3 million, Project Code 21000 \$3.1 million, Project Code 22000 \$3.6 million, Project Code 30000 \$3 million, Project Code 06000 \$9 million (not a reduction but a reallocation within the same code from CAP administrative costs to programs), Project Code 42000 \$500,000, Project Code 82000 \$22 million and Project Code 01700 \$20 million. These reallocations are explained in detailed in Appendix I.

In addition, USAID has revised costs for security requirements. USAID originally estimated \$27.6 million for FY 2005. The revised security costs are \$32.6 million, an

increase of \$5 million. USAID is able to fund \$3.7 million of these costs from within the Agency's current OE budget. The balance of \$1.2 million will come from IRRF II funding.

Past IRRF Program and Management Changes

Implementation of last quarter's programmatic changes has been slow, yet progress has been made:

- Out of the \$225 million job creation initiative announced last quarter, \$29 million was not funded (\$20 million for housing grants and \$9 million in CAP, reducing the total to \$196 million. All electrical, water and sewerage projects have been identified and are ready to commence on receipt of funding. CAP funds will be committed in the next quarter and the USAID micro and small business loans have been obligated. The implementing partner will award the first grants in July.
- In the last report, IRMO announced a \$520 million reallocation and maintenance capacity development strategy in coordination with the Ministries of Electricity, Oil and Water, PCO and USAID. Of this, \$118 million is being used to deploy "Tiger Teams" of USAID-trained Ministry of Electricity Engineers. They are trained Iraqi maintenance trainers and spare parts technicians supported by PCO Engineers to man key power plant sites during the summer peak and improve the reliability of the base-load thermal power plants, which see repetitive trips off-line. This initiative will help strengthen the Ministry's plant O&M responsiveness and capability.
- For the longer term, the IRRF Electricity O&M Strategy of Regional O&M Contractors under PCO is moving forward. The draft specification has been reviewed and commented upon. It is now in final draft with an award expected by early September. This \$103 million O&M program will strengthen the O&M capacity at the individual plants as well as improving Ministerial O&M management by creating a central Engineering group for technical assistance. This program will provide spare parts at around ten thermal and combustion plants for a year.

IRMO has recently implemented a series of initiatives to build upon existing program management practices. First is the development and implementation of the Comprehensive Cost Management Plan. This plan provides the cost management methodology, visibility, and metrics to ensure strategic objectives are accomplished with funds allocated. Second, a standard operating procedure was adopted for managing program and project changes that documents decision authority and processes required to approve changes to a program or project.

As we near the end of the IRRF we are placing greater emphasis on ensuring that funding will be sufficient to move planned projects through to completion of construction, turnover to Iraq for operation and maintenance and successful functioning thereafter.

This cost-to-complete evaluation is now an ongoing part of our management process and oversight.

Looking Ahead

The events and progress of the past quarter include significant milestones in the development of a free and prosperous Iraq. In the upcoming quarter we expect to see continued growth in the cohesion and ability of the ITG, extensive deliberation leading to the drafting of the constitution, detailed planning for the October 15 referendum, and further refinement of their National Development Strategy. Security remains a challenge, as does the inexorable growth in the demand for electricity. We are encouraged by the success of our projects to increase generating capacity, and plan to increase spending on hardening selected infrastructure against attack. As always, our program management, project management, contracting and work management is under careful review and audit, as are the efforts of the ITG under the anti-corruption purview of the Prime Minister, the Board of Supreme Audit, the Ministry of Finance and the Commission for Public Integrity.

SECTOR HIGHLIGHTS

Security and Law Enforcement

Iraq's Security Forces continued to develop toward independent operations in the past quarter. With MNF-I assistance, Army battalions, brigades, and divisions are increasingly able to conduct independent counterinsurgency operations, and police are better able to operate in a counterinsurgency environment.

As part of the FY 2005 supplemental appropriation signed by the President in May 2005, \$5.391 billion is earmarked for the Iraq Security Forces Fund. This Fund, together with IRRF and ITG monies will enable the Commander, Multi-National Security Transition Command – Iraq (MNSTC-I), to help the Ministries of Defense and Interior to acquire the equipment, supplies, services, training, and facilities to continue developing fully effective Iraqi Security Forces capable of defending the country.

This funding will be used to augment current frontline security and police forces, develop support capabilities, and enhance institutional training capabilities. The quick receipt of these funds will allow MNSTC-I to continue its train and equip mission, and will enhance and hasten the transfer of responsibilities to the Iraqi Government a key part of the Administration's overall strategy for Iraq.

Ministry of Defense Forces Summary

Since the last 2207 report the Iraqi Regular Army, Intervention Forces and the Iraq National Guard (ING) have merged into the Iraqi Armed Forces (IAF). Through this ongoing transition initiative, the capabilities of all divisions will continue to evolve as relationships between Iraqi and Coalition forces are strengthened through partnering.

The IAF continues to successfully conduct aggressive counterinsurgency operations in conjunction with coalition forces. The ability to conduct independent operations at lower echelons is continuing to improve. With MNF-I assistance, Army battalions, brigades, and divisions will increasingly be able to conduct independent counterinsurgency operations.

As manning and equipping of the Iraqi Army continues, so does its logistical capability. Training has begun for supervisors and on specialty skills related to transportation, ordnance, and quartermaster functions. A significant element in the Coalition transition effort has been the turnover of Iraqi bases to Iraqi control. The Coalition continues to monitor the performance of life support assumed by the Iraqis, and will continue to turn over Base Support Units at a sustainable pace through the next quarter.

Iraqi and Coalition planners have begun to define Strategic Infrastructure Battalions, whose mission will be to protect portions of Iraq's northern oil pipelines. The USG and the ITG recognize the interrelationships between the provision of security, reconstruction and economic development, and democratic transition, and are discussing how infrastructure security forces can be increased in number, quality and leadership, and be equipped to cover key strategic nodes in other parts of the country and in other sectors of the economy such as electricity transmission.

Ministry of Interior Forces Summary

Special Police Forces continue to develop their capabilities. The 3rd Public Order Brigade and 4th Public Order Brigade were trained, equipped and deployed. The 4th Commando Brigade was raised and equipped. These units continue to successfully conduct counter-insurgency operations in Baghdad, Fallujah, Samarra, and Mosul. In addition, two battalions of a new mechanized police brigade, consisting of wheeled and armored vehicles, are currently conducting operations in Baghdad helping to secure the route to Baghdad International Airport. The Emergency Response Unit (ERU -- a small, highly trained National level hostage rescue unit) now has over 200 operators, and has conducted successful operations in Baghdad, Fallujah, and Mosul. Finally, the Iraq Special Border Force continues to conduct operations in Al Anbar Province.

Special Police Transition Teams (SPTTs) completed training in Kuwait and Taji, Iraq in April. The teams' focus is to mentor and train the Iraqi units while providing access to Coalition capabilities and to facilitate planning and coordination between Iraqi and Coalition units at the operational level. Over 200 independent and coordinated operations are conducted each month.

Police training capacity continues to increase. Sixty members of the Iraqi Police completed the Train-The-Trainer course at the Baghdad Public Service Academy. The Ministry of Interior (MoI) has shifted emphasis to send existing police officers with no prior training to the eight-week basic class, and new police candidates will continue to be

recruited in the reconstituted cities. Sustainment and Integration training programs were introduced to the curriculum during the quarter.

Justice and Public Safety Infrastructure and Civil Society

Significant progress has been made with Justice sector construction projects in the past quarter. Eight of the nineteen courthouse renovations in progress were completed. The new court construction program is underway, beginning with the construction of the new court in the Karkh District of Baghdad. This will be followed in the next quarter by construction on new courthouses in Rusafa District of Baghdad, Mosul, Basrah, and Hillah. The advanced works packages of the new Correctional Institution Projects at Nasariyah and Khan Bani Sa'ad are scheduled for completion by early July. Construction on the main prison construction contracts at these locations will begin in the next quarter. The National Fire Station Renovation Program is scheduled for completion by 30 June 2005.

The Embassy is promoting rule of law in Iraq utilizing the State Department Bureau of International Narcotic and Law Enforcement Affairs (INL) comprehensive, integrated Rule of Law concept. This concept provides the foundation of a strategic approach to justice reform and rule of law development from which the Embassy has identified and funded priority activities that contribute to the broader goals of defeating the insurgency, promoting stability and security and supporting democratic governance. Towards these ends, IRRF funds have been used to fund construction of courts, police and prison facilities; judicial security and training; and increasing prosecutorial capacity, rule of law education, anti-corruption, support to the Central Criminal Court of Iraq, inter-ministerial coordination and integration of the justice system. Funds are also committed to build an independent judiciary, strengthen the criminal legal framework, train legal professionals, prevent human rights abuses in the justice system and develop an Iraqi strategic plan for justice sector reform.

The Embassy/INL has also been coordinating its rule of law assistance with the international community in order to avoid overlap, fill gaps in assistance and ensure efficient use of resources. The Rule of Law Coordinator hosts regular rule of law coordination meetings in which bilateral and multilateral donors are brought together to determine how the international community could better assist Iraqis to promote justice reform and rule of law. This quarter, the Rule of Law Program has worked closely with the EU to rationalize and coordinate similar justice integration programs. The focus of such coordination efforts has turned most recently towards engaging with Iraqis to support them in a strategic planning effort that identifies Iraqi vision and priorities.

Electricity Sector

Our efforts to improve the operations and maintenance of plants, to repair or rehabilitate plants and to complete new generating plants are paying off: the electricity supply continues to grow as measured by peak generation (MW), average daily generation (MW) or electricity supplied (MW-hours). In June 2005, Iraq reached 5,100 megawatts

peak generation and the Ministry of Electricity has the capacity to further increase electrical generation, although sustainability of electricity generation and service must continue to be a priority in the reconstruction of this sector. Demand for electricity is growing faster than production, however, and the Iraqi government will have to mobilize domestic and foreign investment, beyond what the U.S. and other donors have provided, to meet this demand. A key to rationalizing Iraq's electricity sector will be for the Ministry to increase tariffs for electricity consumption and to improve revenue collection. As long as tariffs remain far below the cost of production, Iraq's electricity sector will neither meet demand nor generate the revenue required for rehabilitation of existing facilities or construction of new facilities.

The availability of correct fuels, particularly natural gas and diesel fuel, remains a major problem for Iraq's most gas turbine generation facilities. The use of crude oil and residual fuel oil in these facilities has reduced output and reliability, and increased operation and maintenance (O&M) costs. Under the Summer Electricity Plan, IRMO has facilitated meetings between the Ministries of Oil, Electricity, and Finance, resulting in an agreement to fund an additional 1-1.5 million liters per day of diesel fuel is needed for four months in summer, 2005. The ITG is following through to finance and procure this fuel, but ensuring that adequate diesel supplies for increased summer generation will require continued and diligent coordination between the Ministries. Lack of security of oil, gas and electricity infrastructure, however, remains the central destabilizing factor to the electricity sector. In addition to project delays and cost increases in the reconstruction effort, pipeline and transmission interdictions significantly limit electricity generation and delivery to the Iraqi people.

IRMO, PCO, and USAID continue to support capacity building and institutional strengthening at the Ministry of Electricity. USAID training of Ministry engineers and senior staff in O&M is beginning to show results. A PCO contractor is training the Ministry in Amman in the use of the Electric System Model and long range planning. The Ministry, IRMO, PCO and USAID, have deployed "Tiger Teams" of USAID-trained Ministry engineers, augmented with Iraqi technicians supported by PCO engineers to man key power plant sites during the summer peak in order to improve the reliability of the heavy oil fired thermal power stations. This initiative will help strengthen the Ministry's plant O&M responsiveness and capability. The newly installed Minister of Electricity has initiated changes to his organization to emphasize operation and maintenance, which will help our Build-Train-Transfer approach. The approach looks promising as shown by the successful operation of recently completed projects.

Oil Infrastructure

Crude oil production and exports remain essentially unchanged from the last quarter, at about 2.1 and 1.4 million barrels per day (bpd) respectively. While below the post-war peak production level of 2.54 million bpd achieved in September 2004, the ITG is addressing security, technical and operational issues that cause the sector to perform below its potential. The ITG is funding linear security battalions and a capital budget

which provides for funding in field development and production facilities, pipelines for refining and export and increases to refining capacity.

| Crude Oil Production & Exports | | | |
|---|-------|------|-------------|
| MM barrels per day (bpd) | April | May | June – est. |
| Crude Production | 2.13 | 2.12 | 2.1 |
| Crude Exports | 1.43 | 1.38 | 1.4 |

Continued attacks on the northern crude pipelines have reduced oil production and exports in the north by about 300,000 barrels per day (bpd) during the past quarter. Attacks on Iraq's internal pipeline network continue to disrupt the shipment of crude from Kirkuk to the Baiji and Daura (Baghdad) refineries, necessitating higher-than-expected imports of costly refined petroleum products to meet domestic demand.

The transition from the Interim Iraqi Government to the ITG made it difficult for the Ministry of Oil (MOO) to access its own capital budget during the quarter, but in coordination with MOO, IRMO has been able to move forward on a number of rehabilitation and maintenance projects during the quarter. One major project, with the potential to significantly increase Iraqi oil production and exports, is restoration of the pipeline crossing over the Kirkuk canal and Tigris River at Baiji. IRMO has identified the funding and contractors for this work, which, when completed, will allow Iraq to increase oil production and exports in the north by 200,000-300,000 bpd, subject to security conditions.

Water Resources and Sanitation

During this period the PCO's Public Works & Water (PWW) Sector successfully transitioned from the design and planning phase to the project execution and transition phase. The Sector continues to work closely and to integrate resources with all affected stakeholders including IRMO, PCO, USAID, MSCs, GRD, the Ministry of Municipalities and Public Works (MMPW), the Ministry of Water Resources (MoWR), and the Baghdad city government. This has unified the efforts and improved the ownership by the ministries in anticipation of eventual turnover of the competed project.

A number of complex water and wastewater projects and facilities are soon to be completed and handed over to the Iraqis. There are several key Sector initiatives underway to ensure that these facilities, when completed, will be adequately operated and maintained. These initiatives can be divided into Capacity Development and Transition Management.

In Capacity Development, the Baseline Service Assessment will serve as a platform for future master planning efforts and performance measurements by MMPW. The O&M Planning and Budgeting Structure Initiative will develop a sustainable operation and maintenance (O&M) organization within the Ministry for accurate identification of resource needs and budgets. The Sector continues to work with the Strategic

Management Office (SMO) of MMPW and project management staff in selected directorates to strengthen the Ministry's internal capability for management and oversight of infrastructure projects.

Transition Management includes coordination with ministries, technical advice, development of management systems and tools, developing and overseeing training, overseeing contractor O&M and managing the execution of capacity development by DB contractors. The "Orphan" Project Development Program will assist the MMPW and MoWR in 'marketing' water projects to the international donor community that were eliminated from the IRRF program due to re-allocations.

Transportation and Telecommunications

Progress continues toward the international certification of Baghdad International Airport (BIAP), and the Irbil, Basrah and Sulamaniyyah regional airports. Railroad operations advanced markedly with both cargo and passenger service now available from Umm Qasr in the south to the border of Turkey in the north. Preliminary rail operations also began in the western Al Anbar province with service and repair missions in preparation for service from phosphate mines in Akashat to processing in Al Qaim and delivery as far east as Ramadi, limited by the pending repair of the line in Fallujah, or elsewhere in Iraq via the connection to the main line in Bayji.

Work continues on the National Communication and Media Commission (NCMC) building, a vital component of Iraq's media and communications regulatory body, which is currently 50% complete. Construction was completed on the Wireless Broadband Network and connected to 31 Iraqi Government sites. It is to be accepted by the Iraqi Telephone and Post Company (ITPC) by the end of July 2005, after which a 6-month O&M period then begins.

Roads, Bridges and Construction

The school repair program has completed a total of 611 of the planned 800 schools. While the pace of school starts have slowed in order to ensure funding is available to complete schools and buildings currently under construction, sufficient funds are available to complete the 800-school target.

The scope of the roads projects has been narrowed in order to deliver projects within budget. Currently 43 km of the 424 km in the village road projects have been paved. Work done by local Iraqi firms includes surveying, grading, cutting, filling and laying a sub-base. Contractors in the Tameem and Diyala governorates continue to place asphalt as these materials become available. The national fuel shortage continues to impact the construction of the Village Roads projects. The sub-sector continues to work with the State Corporation for Roads and Bridges to place priority on fuel allocations to the contractors of these projects.

During the quarter, PCO successfully tested a new grant program, intended to support the achievement of several critical reconstruction objectives in Iraq by fostering a long-term relationship between Iraqi ministries and contractors. The initiative selected road and bridge projects through a grant program with the Iraqi Ministry of Construction and Housing (MOCH) is progressing well. This Grant program is supporting several critical reconstruction objectives in Iraq. The program is providing opportunities for closer collaboration between the PCO and the Grantee, which facilitates the achievement of our mutual goals for Iraq. The program increases opportunities for participation by Iraqi and Iraq-based contractors, thereby increasing employment potential for the citizens of Iraq. The projects within the Grant program are critical national highway infrastructure projects selected from an existing list of national and regional priorities. The selected projects will support economic development, national security, and mobility for goods, services and individuals.

The 1st Grant Agreement included the Kufa Bridge, Shirkat Bridge and Al-Diwaniyah—Samawah Carriageway. The 2nd Grant Agreement included the Baghdad-Kirkuk Carriageway, Shaikh Sa’ad Bridge, Zuba Bridge, as well as Nassirriya Bridge and Approaches. The Grant Program is expected to yield significant costs savings over traditional contract methods to the order of 34% savings on Grant #1 and 40% savings on Grant #2. These savings translate into additional project execution capability. We view the Grant Program as a tremendous success that can be used as a model for other donor nations as well as other reconstruction programs. The Grants also provide a procurement system familiar to the Iraqi contractors. We hope to continue the success of the Grant Program.

Health Care

Construction of Primary Healthcare Centers (PHCs) progressed during the quarter with completions anticipated next quarter. Construction delays were due to disputed land ownership, extensive site remediation requirements, insurgent activity, security issues for the contractors, and delivery of construction supplies.

When PHCs cost estimates indicated construction costs were higher than anticipated, the design was modified to maintain the number of PHCs in the budget at 150. These changes included a redesign of the second floor layout to reduce the required square footage. The continued increase in the cost of strategic building materials, extensive site remediation costs and the unilaterally imposed limitation of the Design Builders have caused PCO to issue a stop work order for 20 PHCs. We will work to complete the remaining 130 PHCs, given the current budget. PCO will rebid 12 of these projects for a fixed price subject to ongoing negotiations with the MOH to reprogram funds to cover the additional costs.

The hospital program has grown to 20 hospitals, including such new program facilities as Najaf Teaching Hospital and Baquba General Hospital. With the concurrence of the Ministry of Health (MoH), funding for these additional hospital projects was achieved by transfer funds from other hospital projects that were reduced in scope or cancelled .

Construction is underway at the Basrah Children's Hospital with scheduled completion in the 3rd quarter of 2006.

Expanded Healthcare Centers (EHCs) were determined to be more economically preferable than extensive renovation of five hospitals. The hospitals at the locations not being done will have basic work done, such as roof and elevator repairs and improvements to water systems, and the balance of their budgets will be used to fund the individual EHCs associated with each location. The EHCs will complement the adjoining hospitals and will include space for laboratories, clinics, and beds.

The Ministry of Health continues its efforts to improve primary health care at the community level. In doing so, the MOH still turns to the US and other donors to assist in this task. Domestic resources appear insufficient to meet preventive and primary health care needs. For example, the MOH issued urgent appeals to the USG to support its recent immunization campaigns against polio and measles, mumps and rubella. Basic health services still need technical updating and other improvements to achieve the quality of care desired by the MOH.

Private Sector Development

During the quarter, Iraq made significant strides towards WTO accession. Iraq expects to submit its Foreign Trade Memorandum (FTM) to the WTO Secretariat in July 2005 and will then begin negotiations when the Secretariat schedules the first meeting of the Working Party on Iraqi accession. OPIC's Iraq Middle Market Development Foundation facility, which makes loans to Iraqi private companies up to \$130 million, has submitted five projects for approval. USAID has supported the establishment of an Iraqi Investment Promotion Agency, which will open its doors in July.

The USG is implementing a broad range of assistance programs to help Iraq move to a free trade, private sector, market based economy. Fundamental market reforms are essential to Iraq's economic growth, job creation, and equal opportunity. In turn, economic growth is essential to political stability.

IRMO and USAID are working together to implement numerous development and assistance programs. Highlights of the programs include: micro-finance, bank lending to small and medium sized enterprises, capital market development, business skills development, vocational training, investment promotion, business center support, and establishment of economic zones. Broad policy issues are being addressed and resources allocated to provide assistance for vital reforms such as privatization, accession to the WTO, and multi-pronged programs for the agricultural sector that will bear countless benefits to the economy of Iraq.

Education, Refugees, Human Rights, Democracy, Governance and Civil Society

The State Department's Bureau of Democracy Rights and Labor (DRL) administers \$82 million from the FY04 Iraq Relief and Reconstruction Fund. Of this, approximately \$75

million has been obligated, with the remaining \$7 million set aside for pending initiatives and administrative costs.

For democracy promotion, DRL awarded the National Endowment of Democracy (NED) a total of \$60 million for Iraq electoral and government initiatives. The International Republican Institute (IRI) and the National Democratic Institute (NDI) are the primary sub-recipients of this funding which was obligated in three tranches of \$25 million, \$5 million and \$30 million. NED has obligated almost all of this funding.

Of the remaining \$22 million, \$5 million has been awarded to six NGOs for human rights projects and one has been awarded to the United States Institute of Peace (USIP) in the amount of \$2.9 million to support the constitution development process. Of the \$10 million allotted for Iraqi women's initiatives, \$7.8 million was awarded to seven NGOs with pending grant proposals to exhaust the remaining funds. DRL issued a second Iraq Human Rights RFP to solicit proposals which will soon obligate the remaining human rights funding, approximately \$4 million.

Some programs, particularly the smaller human rights activities, continue to suffer from a slow rate of implementation primarily as a result of security and long-term stability factors. DRL, however, continually engages partners in a needs-based analysis for future programming, focusing on priority areas such as democracy and human rights education, support for civil society, journalism training and media reform, ensuring democracy and human rights components of legislative strengthening and executive branch support programs (mainly funded by USAID), prison monitoring, human rights documentation, and reaching out to women and youth.

USAID's education program works closely with the Ministry of Education (MoEd) and local Directorates of Education throughout Iraq to build their capacity to create and maintain a high quality education system. The centerpiece of USAID's education program is the establishment of 84 "model" schools, four in each governorate and 16 in Baghdad, to pilot child-centered teaching styles coupled with computer and science labs. Once established, the goal is for the MoEd to replicate these "centers of excellence" throughout Iraq to serve as the basis for the transformation of the Iraqi education system. In the past quarter, USAID trained over 90 trainers who will go on to train educational professionals and teachers in pedagogy and English. The education program also rehabilitated 48 halls in teacher-training centers in eight governorates throughout Iraq and awarded 37 grants to parent-teacher associations (PTAs) in Iraq's poorest communities to reconstruct schools.

Commander's Emergency Response Program (CERP)

During the previous quarter, MNF-I units began work on 1428 CERP-funded projects throughout Iraq and completed 761 projects. During the next quarter MNF-I units, in cooperation with Gulf Region Division (GRD) and Joint Contracting Command – Iraq (JCC-I), are expected to obligate more funds and start more projects than any previous

quarter. CERP will continue to be the catalyst for building trust and support for the Coalition and help establish the legitimacy of the ITG.